

IRS TAX TIP 2001-33

EDUCATION IRAS CAN MAKE COLLEGE COSTS LESS TAXING

WASHINGTON -- The Education IRA is an incentive to help parents and students save for higher education. Up to \$500 may be contributed to a child's Education IRA each year. Earnings on contributions will be distributed tax free provided that they are used to pay the beneficiary's postsecondary education expenses.

Any individual who meets adjusted gross income (AGI) requirements can make a non-deductible contribution on behalf of a child under the age of 18. The AGI requirements are \$95,000 for single taxpayers and \$150,000 for married taxpayers. The \$500 annual contribution limit is phased out for single taxpayers with AGI of \$95,000 to \$110,000 and for joint filers with AGI of \$150,000 to \$160,000.

While a child may be the beneficiary of any number of Education IRAs, the total contributions for the child during any tax year cannot exceed \$500.

Distributions are tax-free as long as they are used for qualified education expenses, such as tuition, books, fees, room and board, etc. This income exclusion is not available for any year in which the Hope credit or the lifetime learning credit is claimed for that student. If the distribution exceeds education expenses, a portion will be taxable to the beneficiary and will be subject to a 10% tax penalty. Exceptions to the penalty include death, disability or if the beneficiary receives a qualified scholarship.

If there is a balance in the Education IRA at the time the beneficiary reaches 30 years old, it must be distributed within 30 days. A portion representing earnings on the account will be taxable and subject to a 10% penalty. The beneficiary may avoid this tax and penalty by rolling over the full balance to another Education IRA for another family member.

For more information, check out IRS Publication 970, "Tax Benefits for Higher Education." It's available at the IRS Web site at www.irs.gov under the "Forms & Pubs" section. It can be accessed directly at ftp.fedworld.gov/pub/irs-pdf/p970.pdf.